

EVALUATION OF OUTSOURCING : A CASE ANALYSIS OF

LEVER PONDS (MAYDON WHARF)

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By

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## EXECUTIVE SUMMARY

The aim of the study is to assess whether or not the outsourcing of production at the Lever Ponds Maydon Wharf factory has been successful from a financial and operational perspective.

Chapter one gives a background as to why outsourcing has been essential at the Maydon Wharf factory. The chapter also outlines what potential dangers Lever Ponds may be exposed to as a result of outsourcing production to outsourcing companies.

Chapter two is a literature review of studies that have been undertaken in instances where production has been outsourced.

Chapter three outlines the research methodology of the study.

Chapter four gives a numerical breakdown and a brief overview of the findings.

Chapter five is a detailed discussion of the findings.

Chapter six sets out the recommendations of the study and provides a conclusion to the study.

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## EVALUATION OF OUTSOURCING : A CASE ANALYSIS OF LEVER PONDS (MAYDON WHARF)

### 1.1 CHAPTER ONE

#### 1.2 PURPOSE OF THE STUDY

The purpose of this study is to investigate whether outsourcing is beneficial to Lever Ponds (Maydon Wharf) from a financial and operational perspective. The Maydon Wharf plant of Lever Ponds has been outsourcing its products to outside companies for a considerable length of time, as and when the need arose. However, the number of products that have been manufactured by outsourcing companies has increased dramatically during the last four years, since 1998. This study will try and investigate what financial and operational risks the high level of outsourcing poses to Lever Ponds. Recommendations of corrective and preventative action will also be given.

The subject is of particular interest to the writer, as she works in the Accounts section of the department that deals with outsource (third party) production.

Outsourcing can be termed as transferring of a business process to a supplier, usually on a long-term basis. Gaar (2001). Gaar further points out that companies usually out source their products to be able to concentrate on core competencies, provide improved levels of customer satisfaction and to be more cost effective.



McEachern (2003) states that " the drive toward outsourcing is most visibly dominated by cost savings, but it is also being driven by improved service levels and efficiencies, the need to consolidate following the technological booms of the 1990s, and the fact many firms simply want to get back to concentrating on core competencies."

## 2. Reasons for Outsourcing at Lever Ponds

### 2.1 Capacity Constraints at the Maydon Wharf Factory

Due to seasonal customer demands for certain products, the Maydon Wharf factory could not cope with the higher demand and production levels. In order to meet the market demand, outsourcing companies were contracted to manufacture production units that the factory was unable to do. In the event of unforeseen circumstances such as line stoppages, possible production glitches and possible industrial action outsourcing companies were contracted to prevent the possibility of lower production levels. In the event of the factory workforce being unable to meet core factory production, (production ordinarily done at the Lever Ponds factory) a contingency measure in the form of outsourcing companies was available.

Utilising outsourcing companies ensured that any possible shortage in production units was minimized.

## 2.2 Concentration on Core Competencies and Downsizing

In the late 1990s, Lever Ponds embarked on a strategy to make its factories more efficient. This was done by introducing projects that aimed to introduce procedures that would make production more automated with need for less manual intervention, shutdown of facilities that necessitated high maintenance costs and providing better quality goods and services to consumers. Due to these procedures being implemented, fewer products were manufactured at the factories and outsourcing companies were contracted instead. Outsourcing some of the production resulted in the factory concentrating solely on the production of core products. The strategy of producing core products in house and outsourcing the balance of production was aimed at reducing factory overheads, production and maintenance costs. The factory workforce decreased as staff was offered retrenchment packages or were re-skilled so that they were able to work in other areas, as their workstations were shutdown.

Lever Ponds' core products are those that have historically high production and sales volumes. The products have also been available to consumers for a considerable length of time and consumers identify Lever Ponds with these products. Examples are Lux and Sunlight soaps and Dawn Lotion. Due to the high production and sales volumes of core products, the factory was still able to operate at optimum capacity, although the non- core products were contracted to outsourcing companies for production.

Employer

Retrenchment packages given to staff result in a big cash outflow, but in the long run this outflow is recouped as due to outsourcing; the company no longer needs to pay for administrative costs such as provident fund and medical aid payments.

In some instances some products are manufactured exclusively by third parties. This may be because the factory may not want to spend funds on capital outlays for specialised machinery that these products may need for the manufacturing process. In addition to this, the cost of upgrading and maintaining machinery may be very high. The use of outsourcing companies' for manufacture will avoid these high maintenance costs.

The use of outsourcing companies is also beneficial when Lever Ponds wants to test the market response to a new innovation. The initial production of the product will be done at outsourcing companies and the customer demand will be assessed from production and turnover figures. Plans will only be made to make investment for additional machinery when the expected turnover figures are realised.

### **2.3 Cost effectiveness**

Due to outsourcing, the costs that would have been incurred to purchase specialised (especially for new project trials) machinery, maintain the plant and pay employees were vastly decreased. The extra cash flow available to Lever Ponds after outsourcing production could be used in other areas, such as to enhance core competencies such as marketing, research and development. Direct overheads as well as administrative costs are vastly reduced due to outsourcing.

As mentioned earlier, Lever Ponds has opted to keep the production of core products in house. By doing this, the factory is able to recover costs due to the large number of volumes of core products that are produced.

### **3. BACKGROUND OF THE PROBLEM**

In March 2002, approximately 50% of hair, 35% of skin, 32% of dental and 33% of deodorant products were manufactured at outsourcing companies. Since this is a substantial number of products, which will have an effect on sales, profits and customer satisfaction, care has to be taken to avoid financial risks, low quality levels and customer complaints.

**The Following Pose Financial Risks to Lever Ponds:**

- 3.1 Stock losses for raw materials that are owned by Lever Ponds, but are at the outsourcing company's premises.

Lever Ponds policy regarding stock and outsourcing companies is as follows:

(3.1.1) The outsourcing company may source its own raw materials and supply Lever Ponds with the finished product.

(3.1.2) The outsourcing company may source some of the raw materials and the balance will be bought from Lever Ponds.

(3.1.3) The outsourcing company may buy raw and packaging materials from Lever Ponds. Lever Ponds will in turn buy the finished goods from the outsourcing company.

(3.1.4) Lever Ponds will provide raw and packaging material to the outsourcing company. The outsourcing company will convert the raw materials to finished goods. Lever Ponds will pay for the cost of conversion.

In cases where there has been an exchange of stock (raw and finished goods) between Lever Ponds and the outsourcing companies the terms of payment are 30 days for both parties.

3.2 Outsourcing companies may default on payments for stock they purchase on credit from Lever Ponds, making them a potential bad debt risk. This applies where the outsourcing company does not settle debts within the 30 days payment terms.

3.3 Outsourcing companies have access to confidential market sensitive information, which if released to competitors would affect the competitive advantage of Lever Ponds, for example bills of material and formulas for the manufacture of products. Although Lever Ponds does have a confidentiality clause in its agreement with the outsourcing company, this clause may be breached.

3.4 The computer systems at Lever Ponds are currently not designed to give automated management reports for transactions between Lever Ponds and outsourcing companies. The current practice of using Excel spreadsheets to generate reports may result in

inaccurate data. Plans are under way to design a program that will generate automated reports.

### **3.5 Low Quality Levels**

When the outsourcing relationship between Lever Ponds and the outsourcing company is still new, the outsourcing company will not always be familiar with production procedures specific to Lever Ponds products. Before initial production of Lever Ponds products starts at a newly contracted outsourcing company, there are intensive training sessions run by the Lever Ponds Quality Assurance Department. The outsourcing companies' production and technical teams are involved in the training sessions. Procedures are also in place to test samples of products manufactured at the outsourcing company for any quality defects. This study will aim to investigate whether Lever Ponds is exposed to any potential lowering of quality standards as a result of contracting outsourcing companies.

## **4. BACKGROUND OF THE STUDY**

The study will aim to highlight the problems that Lever Ponds is exposed to due to outsourcing its products to outsourcing companies. As has been mentioned earlier, Lever Ponds may be exposed to financial risks, low quality levels and customer dissatisfaction.

## 5. RESEARCH DESIGN

The study will highlight the measures Lever Ponds has implemented to prevent losses and products of low quality that are produced at its outsourcing companies. Weakness to the systems will be mentioned and possible corrective action that could be implemented.

The sample will be drawn from three out of nine outsourcing companies used by the Maydon Wharf plant. Thus the sample will be a non-probability convenience sample.

The research technique will be a combination of qualitative and quantitative data, but emphasis will be placed on analyzing information from qualitative data.

The research questions will consist of a semi- structured questionnaire.

The respondents will also undergo a short interview, which will assist to add to the information in the questionnaire. The interview will be unstructured.

## 6. LIMITATIONS

Due to logistical and budget constraints, the researcher will study three out of the five outsourcing companies currently being contracted by the Maydon Wharf plant. Maydon Wharf plant has nine outsourcing companies in its database. Currently, the services of only five of the outsourcing companies are being used. The services of the other four outsourcing companies have not been used for approximately a year for the following reasons:

- The outsourcing company used to produce a product that has since been discontinued.
- The proximity of outsourcing company to Lever Ponds was far, thus increasing costs such as transportation. Due to distance; communication and face to face interaction between the staff of the the outsourcing company and Lever Ponds may be difficult. In such cases, the services of an outsourcing company nearer Lever Ponds have been contracted.
- The project for which the services of the outsourcing company were used has been completed.

As the sample does not cover all the outsourcing companies, the results of the study may not be generalisable.

Management and staff of the outsourcing companies and Lever Ponds will be part of the study. An attempt will be made to get equal representation from management as well as from staff.

## 7. CONCLUDING SUMMARY

Outsourcing of production at Lever Ponds is necessary so that the Maydon Wharf factory can meet capacity demand. The company also wants to concentrate on producing core production and enhancing its core competencies. Further to this, due to the companies' strategy to make its factories more effective, there is need for less manual intervention and



lower production and maintenance costs. The lowering of costs ultimately being achieved through outsourcing.

Outsourcing has brought about the following problems: potential for financial losses, possibility of lower quality products and risks associated with confidentiality.

This study will aim to highlight the extent to which Lever Ponds may be exposed to risks due to outsourcing. Preventative and corrective measures Lever Ponds needs to implement in order for the outsourcing relationship to be beneficial to Lever Ponds as well as to the outsourcing companies will also be outlined.

## CHAPTER 2

### 2.1 LITERATURE REVIEW

The literature review will investigate the results of other studies that have done in the outsourcing field. Attention will be paid to the results of the studies. The impact of the results on the topic under discussion will also be looked at.

Goolsby, (2002) states that thriving companies join forces with outsourcing service providers. Instead of just using the outsourcing as a tactical means of driving costs and inefficiencies out of a business process or function, they use the outsourcing relationships to strategically enable their capability of doing business better than their competitors.

The literature review will touch on the following topics:

(2.1.1.) the strategies of the outsourcing company and the parent company

(2.1.2.) the formation of other supply chain functions between the  
outsourcing company and the parent company

(2.1.3.) stability, reputation and financial security of outsourcing company

(2.1.4.) business relationship between outsourcing company and parent  
company

(2.1.5.) trade-offs between outsourcing and in house production.

(2.1.6.) outsourcing from a South African perspective.

### 2.1.1. STRATEGIES OF OUTSOURCING COMPANY AND PARENT COMPANY

Goolsby (2002) states that the strategies of the parent and outsourcing companies should be such that a business relationship is formed, so as to enable the parent company to stride ahead of its competitors. In order to achieve this relationship, the outsourcing company and the parent company must share the same values, integrity, and excellence in all they do, focus on customers and treating people with dignity and respect. All of those values require patience and flexibility. Cognisence should be given to the fact that achieving a sound working relationship between the parent and outsourcing company will take time and a great deal of understanding.

### 2.1.2. FORMATION OF OTHER SUPPLY CHAIN FUNCTIONS BETWEEN OUTSOURCING COMPANY AND THE PARENT COMPANY

Goolsby, (2002), further states that in the case of manufacturing companies, warehousing, distribution and other supply chain factors are essential ingredients for the success of an outsourcing relationship. Goolsby advises that the outsourcing company and the parent company extend their relationship to include logistics. In some instances though, the outsourcing company may not be able to supply the parent company with supply chain functions, due to the high costs associated with setting up a supply chain service . In such instances, the outsourcing company or the parent company

may opt to outsource the supply chain function to another company. In this way, the delivery of the goods will be quicker and service levels desired by the customers will be met.

### **2.1.3. STABILITY, REPUTATION AND FINANCIAL STABILITY OF THE OUTSOURCING COMPANY**

Gunsauley, (2003) states that an outsourcing company must show the capabilities of performing the task at hand, before a contract is entered into. Most outsourcing contracts are based on renewable annual contracts that include performance guarantees. Should the outsourcing company not be able to meet the set performance guarantees, the parent company has an option not to renew the contract. Further to this, other qualities such as overall quality, service, technology and price are also very important. Outsourcing companies that can provide additional operational characteristics that would in the end enhance the parent companies competitiveness are also an advantage.

Bhagattjee (2003), states that it is important to specify critical trigger events that would automatically be considered a material breach under the contract agreement between parent and outsourcing company, in order to allow for termination.

Mayes (2003) argues that a great deal of preparation has to be done by the outsourcing and parent companies before entering into an outsourcing contract. Market dynamics and the parent company's needs and expectation may change over time. The outsourcing company should have mechanisms in place that will cater for any changes in the market environment. On the

other hand, the parent company should be aware of how changing market dynamics affect its strategy and inform the outsourcing company accordingly of any impending changes in the terms and conditions of their original contract. Mayes goes on to state that most outsourcing deals fail due to lack of communication on both sides. Due to this, it is imperative that the parent and outsourcing companies have frequent meetings and correspondence between themselves.

Research done by research group Gartner Incorporated, (Canada) in 2002, indicates that approximately 50% of outsourcing deals are deemed failures due to the parent company's expectations not being met. Less than 30% of the companies surveyed had formal plans for managing long term relationships with their outsourcing companies. As no formal policies and procedures were documented, the parties had no solutions when problems arose. McLuckie (2003) states that a big challenge facing parent companies is that they do not always know what they want out of the outsourcing deal. As the reason for outsourcing is not unclear from the onset, it will be difficult to measure the gains or losses of the outsourcing relationship.

Further to this, there was a high incidence of "golf course deals," whereby the management of the parent and outsourcing companies formalised an outsourcing contract without any concrete figures for expected returns, expected savings and pricing. Little if any attention was given to issues such as changing market dynamics, effects of exchange rate fluctuations on pricing and subsequent changes in the costing structures. All too often, in such deals, the management teams that initially negotiated and agreed on the contract are not part of the operational team that has to facilitate the deal. The absence of the initial management team makes it difficult for the

operational staff, when things do not go according to the terms and conditions outlined in the outsourcing contract. This is further compounded by the absence of any formal agreements on financial matters.

MacInnis (April 2003) states that unrealistic expectations on the part of the parent company lead to failed outsourcing deals. Parent companies usually rely on outsourcing companies to correct their failures and weaknesses. Outsourcing can help companies to solve specific problems, but only if they have a clear map of their objectives up front. McLuckie (April 2003), also states that in some instances companies having made the decision to outsource when they have let their equipment and infrastructure to run down, then expect the outsourcing company to perform miracles. These companies may outsource for the wrong reasons and may enter into an outsourcing relationship with the premise of "the same mess for less."

Hanna in MacInnis (2003) says that companies should "straighten out their mess before they outsource it," so that they are in the position of measuring their performance levels before and after outsourcing. All too often, the parent company is of the opinion that the outsourcing company will sort out problems and administrative backlogs that they could not deal with. This is very dangerous as the parent company relegates the responsibility of sorting problems out the outsourcing company. The outsourcing company is seen as inefficient if it fails to sort out problems, which may cause ill feelings between parties.

Cooke in Gunsauly, (2003) states that when parent companies employ the services of an outsourcing company, a large number of parent companies do

not comply with government regulations for issues such as human resource policies. Due to outsourcing, the company can move towards compliance, as compliance with government regulations may be a requirement for contract renewal.

According to a study done in IDC Canada and Accenture (a company that provides an outsourcing service) in January 2003, it was noted that it is important that when contracts are signed, both parties have common agreement and understanding on issues that are transactional in nature. A concern that was raised by the researchers of the IDC Canada and Accenture study is that one out of every five companies did not measure the success and failure rate of their outsourcing contracts. Those that did used outdated historical data and not industry benchmarks, as would have been expected. Continuous assessment to ascertain whether or not outsourcing is beneficial to the parent company is needed, especially for rating the quality levels of the outsourcing company, awarding of further contracts and for assessment of costs.

Gunsale, (2003) states that according to a study of benefit professionals, more than 92% of the respondents stated that an outsourcing company's specialised capabilities delivers significant benefits for their organisations in terms of improved services. Improved systems also enable the company to adhere to government regulations and to spend more time on concentrating on core competencies.

Some service orientated outsourcing deals have lead to dissatisfaction from the parent companies, as parent companies feel the outsourcing companies fail to use creative ideas and tend to have "off the shelf" packages for

services such as events organising, catering and entertainment. In some instances, the outsourcing company dictated to the parent company what would be the best options, instead of working on negotiated options. The outsourcing company also tended to favour and implement ideas and plans that would be most suited to their capabilities and scale of operation; they did not want to be inconvenienced in trying to provide a service that would suit the client best. (Hosford, 2003).

Preeta Bhagattjee, director of law firm Cliffe Dekker emphasises that outsourcing and service level agreements should not be seen as one-size-fits-all. Each agreement should be tailor made to suit each parent and outsourcing company. For the outsourcing relationship to be a success, each agreement should be custom-tailored to the specific service needs and budget of the customer.

(Business Day, September 05, 2002).

#### **2.1.4. BUSINESS RELATIONSHIP BETWEEN OUTSOURCING COMPANY AND PARENT COMPANY**

The results of the study of IDC Canada and Accenture showed that the parent and the outsourcing companies need to work on a relationship that is adaptive in nature. The relationship should be seen as one of both parties being partners and doing everything for the mutual benefit of the partnership deal. A healthy working relationship between the parent and outsourcing companies will assist both parties to achieve the next level of business performance.



In order to make themselves appear the cheapest bidder, smaller outsourcing companies at times under quote their costs, which may at times, have disastrous consequences. Park ( 2003) cites the case of Electronic Data Systems Corporation, a company that quoted up to \$1.7 billion less than other larger competitors such as IBM in order to be awarded a tender to merge 1000 networks. Further to this, the company agreed to thin profit margins, but also to terms that delayed payment for equipment and salaries until the parent company gave its approval. Operational problems caused the outsourcing company not to meet its agreed deadlines. Due to this, payment from the parent company has not been forthcoming, despite the contract being in its third year of operation. The outsourcing company has run into severe cash flow problems and shutdown some of its business units and retrenched staff. The respective parties are blaming each other, the parent company feels that the outsourcing company did not plan appropriately and the outsourcing company feels the parent company is not geared at finding solutions to the problems.

#### **2.1.5. TRADE OFFS BETWEEN OUTSOURCING AND IN HOUSE PRODUCTION**

McEachern (2003) states that companies outsource due to cost savings, improved service levels and efficiencies, consolidation and concentration on core competencies. A study conducted to investigate why companies outsource showed that 92% of the respondents outsourced due to the outsourcing company's ability to provide specialised customer capabilities and 86% of the respondents outsourced due to cost reduction. MacInnis (2003) argues that outsourcing is no longer seen as a method of reducing costs, as

was the case a few years ago. Parent companies now see access to skilled resources and focus of core competencies as important reasons of entering into outsourcing contracts.

According to Fidelity executive vice president, Brian Cooke in Gunsaulley (2003), "administrative costs are not jumping out as a big unknown surprise for companies that outsource. They are seeing costs becoming predictable while they avoid capital investments." Organisations often make the decision to outsource when they reach a point where significant capital investments are needed to upgrade internal systems. Rather than incur higher costs in investing in capital equipment, the outsourcing route proves the cheaper option.

Andrew Teixeira, in Business Day, (19 February 2003), states that for non-core activities, such as security and cleaning services, there is a high personnel component and consequently the human resource cost is high. If the security and cleaning departments together with the management of personnel are outsourced, then the parent company should experience a lowering of costs in these areas.

The outsourced service provider focuses on the activity as their core business and as such, is more likely to invest in machinery and the latest IT infrastructure and implement the latest trends to improve efficiencies in the management of the portfolio. Bulk purchasing of equipment and supplies can be made use of by the outsourced service provider, and discounts negotiated, that are then generally passed to the client.

Potential disadvantages of outsourcing include loss of control, as the parent company no longer has a say in the manner in which the departments that are outsourced are run.


Soat (2003) highlights the problem of outsourcing companies that use cheap labour being able to secure more contracts than their competitors as they are able to offer cheaper rates. This problem has been highlighted in the United States of America, where outsourcing companies that have a large number of immigrant employees, who are employed at lower salaries than indigenous Americans can afford to have lower administration costs. Rather than being unemployed, the immigrants opt to be employed at low salaries. As the administration costs of such outsourcing companies are lower than those of their competitors, these outsourcing companies are able to acquire a higher number of contracts. Further to this, some outsourcing call center companies are establishing some of their business operations in foreign countries, so as to take advantage of lower wage rates in those countries. Due to paying lower wages, their overheads are reduced and this enables the outsourcing company to be more profitable than its competitors. Such outsourcing companies also attract more business as they offer lower rates than their competitors. In order to protect local jobs, many European and United States firms may begin to place on restrictions on migrating their outsourced services to foreign shores.

Small, medium and Micro Enterprises (SMEs) usually benefit from outsourcing their information and communications technology systems. This is so, as due to their size, SMEs do not have the technical capability or financial resources to upgrade their information and technology systems on a

continuous basis, as to keep abreast with the changes in technology. Other incidental costs, for instance, maintenance cost, equipment and parts upgrading are also taken care of by the outsourcing companies.

Derek Brown, regional director for Gauteng Computer Sciences Corporation (CSC), a global outsourcing company states that outsourcing companies can afford to do the job for less for the following reasons:

1. An outsourcing company is more commercially focused, has one set of overheads to service many clients and the unit cost is therefore lower.
2. Scarcity of skills. An outsourcing company that provides a specific service has skilled workmanship with the necessary capabilities to perform the required tasks.
3. An outsourcing company only pays for the overheads it needs and not the whole overhead.
4. Staff taken over from the parent company, may be faced with a culture <sup>employee</sup> shock, as work has to be done faster, better and cheaper. (Business Day, Sept 5, 2002). Adjusting to the quicker pace may be difficult and may be a source of discontent among some employees, leading to low morale among staff.

 Ian McLuckie, national bid manager at EDS states "that when staff have been outsourced as part of the deal, some will group the new opportunities presented to them, others who effectively have been in a protected environment will be faced with the reality that outsourcing is a tough game." (Business Day, April 10, 2003).

McLuckie is of the opinion that when production is outsourced and staff retained, it is best to disband the original team as the client will want more creative ideas which will not be possible if the original team is still operational.



#### 2.1.6. OUTSOURCING FROM THE SOUTH AFRICAN PRESPECTIVE

Although countries such as China and India are fraught with external and internal political troubles, they are the favoured destinations for outsourcing overseas for many American and European companies. The reason is that it is far cheaper to outsource there than in the mother countries. South Africa has a huge opportunity to outsource to overseas providers, as the Rand remains relatively weak, (despite some strong rallies during the earlier part of 2003), local skills are competitive and the country is politically more stable than some standard outsourcing destinations. (Business Day, April 29 2003). Despite having competitive traits, South Africa ranks low on the international outsourcing list. In order to lure international providers, South Africa has to prove that it has the capabilities to provide a satisfactory service, further to this, the South African companies should aim to <sup>all</sup><sub>ay</sub> the fears of lack of security and high crime levels. Local companies also have to show that they can do the job at a competitive price.

Crucially, South African companies must emphasize the value they share with their potential clients. Clients may be unfamiliar with South African business practices and therefore need to be assured that both parties' value universally admired values such as integrity, quality and punctuality.

According to research done by Accenture, only 50% of South African companies that have signed outsourcing deals are happy with the services they are receiving. The discontent is highest in the financial services sector (85%). The study shows that South Africans are generally more dissatisfied with their outsourcing deals than their international counterparts. Often the problem is that the outsourcing supplier oversells its services, exaggerating its capabilities. Local outsourcing players do not work on tight margins foreign counterparts do, so the cost savings are subsequently smaller. Another problem is that outsourcing firms often clinch deals by agreeing to absorb staff who previously ran an operation house in-house, and promise no retrenchments. Yet the staff they inherit might lack the right skills or mental attitude to add value to the outsourcing firm.

## 2.2 CONCLUSION

For the outsourcing relationship to be successful, it has to be a "win-win" partnership between the parent and outsourcing companies. Constant interaction between the parties has to take place and areas of difference need to be solved as they arise. Problems between parent and outsourcing companies have arisen when the outsourcing company has over stated its capabilities (in order to be awarded the outsourcing contract) and fails to deliver promised results. The parent company may also have high and unrealistic expectations of the outsourcing company. The parties that were initially involved when the deal was finalised and agreed to, should be part of the operational team when production begins, in order to avoid misunderstandings and deviation from agreed procedures.

## **CHAPTER THREE**

### **3.1 RESEARCH METHODOLOGY**

### **3.2 OBJECTIVES OF THE STUDY AND PROBLEM STATEMENT**

The objective of this study will be to identify weaknesses in the outsourcing relationship between Lever Ponds and outsourcing companies.

Recommendations as to how these weaknesses can be corrected will be made.

### **3.3 PROBLEM STATEMENT**

What are the weaknesses in internal controls in Lever Pond's outsourcing process? To what extent do the weaknesses in internal controls have an impact in the monetary value of stock and wastage figures?

### **3.4 RESEARCH DESIGN AND METHODOLOGY**

The study will be cross-sectional, as it will be done on a once off basis. The research technique will be a combination of quantitative and qualitative data, but the emphasis will be on qualitative data. The sample group of Lever Ponds and outsourcing company staff will be expected to answer a structured questionnaire and undergo a semi-structured interview.

Presently, Lever Ponds (Maydon Wharf site) contracts the services of nine companies as outsourcing companies. In the study, Quality Products, Paccon Research and Kelly Foods CC will be studied. Quality Products has been chosen because it manufactures the largest number of outsourced products.

Paccon Research and Kelly Foods CC have been selected due to their proximity to the researcher. In each outsourcing company, the following personnel will be selected to be part of the study:

### **3.5 OUTSOURCING COMPANY-SAMPLE**

- 1 director/owner
- 1 production manager or
- 1 relationship manager
- 1 assistant account
- 1 laboratory technician

The director/owner, production manager and relationship manager of the outsourcing company have been selected to be part of the study, as they each have a complete picture of the companies' operations. One of the respondents stated that "when I was still employed at Lever Ponds, I concentrated solely on my department. Being here has given me a feel of what it is like to run a business. I have knowledge of what is going on in the factory, I am involved with HR issues and I am also aware of financial issues."

In most instances, the management of the outsourcing companies is the line of communication between their companies and Lever Ponds. All Lever Ponds production undertaken by the outsourcing company is negotiated and agreed to by the management of the outsourcing companies. Management involvement continues throughout the manufacturing process, to testing and final approval. A director from an outsourcing company remarked that "we consider ourselves as the quality assurance department, we constantly check



that everything is going according to plan at each stage of production. We are aware of each batch that leaves our factory floor."

The assistant accountant and laboratory technician were selected to be part of study so that they can give insight to details that are particular to their line of work.

The following will be part of the study from Lever Ponds:

### 3.6 LEVER PONDS - SAMPLE

- 1 Production manager
- 2 Third Party Planners
- 1 Third Party Assistant Accountant
- 1 Third Party Accountant
- 1 Supply Chain Accountant
- 1 Quality Assurance Manager
- 1 Human Resources Manager

The names of the personnel in these positions will be obtained from personnel records in the Human Resource Department.

### **3.7 DESIGN AND ANALYTICAL TECHNIQUES**

#### **3.7.1. METHOD OF DATA COLLECTION**

##### **3.7.1.1. PRICES AND PROFITABILITY LEVELS**

The researcher will obtain information from financial documents such as purchase orders, invoices, pricing schedules, sales reports and customer complaint reports. The questionnaire, with a covering letter will be mailed to the respondents from the outsourcing companies. The staff at Lever Ponds will receive the questionnaire with a covering letter via the internal e-mail system. The questionnaire from the Lever Ponds and outsourcing company respondents will be collected from the respondent on the same day the interview will be conducted.

An ex post facto design will be used, as the respondents from Lever Ponds and outsourcing companies will complete the questionnaire and conduct the interview in their natural work settings. The study will also be explanatory, as the relationship between in house production (as per Lever Ponds) and outsourcing (as per the outsourcing companies) and its effect on customers will be studied.

##### **3.7.1.2. WEAKNESSES IN OUTSOURCING CONTROL PROCEDURES**

The researcher will obtain information from reports in the accounting system as well as the results of costing, audit and customer complaints reports. The information will be collected from financial records.

#### **3.7.1.3. PRICES AND CUSTOMER SATISFACTION**

The researcher will obtain information regarding prices from pricing schedules. A comparison will be made between product prices if production is outsourced or produced in house at Lever Ponds. The comparison will be used to assess whether there is a difference in sales levels if the products are produced in house or by the outsourcing companies. The information will be collected from financial records.

#### **3.7.1.4. DATA ANALYSIS TECHNIQUES**

The data obtained from the returned questionnaires of staff at Lever Ponds (Maydon Wharf site), Quality Products, Paccon Research and Kelly Foods CC will be quantified and recorded on a Balanced Scorecard. The study will aim to investigate the following aspects of the relationship between the staff at Lever Ponds and outsourcing company:

#### **3.7.1.5. FINANCIAL**

What is the perception of the staff at Lever Ponds and the outsourcing company regarding:

- Magnitude of costs incurred in the outsourcing process.
- Costs incurred in outsourcing vs in house production.
- Impact of costs on prices, sales and profitability levels.

- Is there a cost saving in the outsourcing exercise-i.e. is it cheaper and cost effective to outsource production or to produce it in house, at Lever Ponds.

#### **3.7.1.6. BUSINESS PROCESS**

What is the perception of the staff at Lever Ponds and the outsourcing company regarding:

1. Procedures implemented to aid in the compliance of internal controls and maintenance of quality standards.
2. Criteria for choosing outsourcing companies.

#### **3.7.1.7. LEARNING AND GROWTH**

1. What is the perception of the staff at Lever Ponds and the outsourcing company regarding:
2. Staff development, progression and advancement.
3. Financial enhancement of staff in the form of share option schemes.

### **3.8 BENEFITS OF THE STUDY**

As mentioned earlier, Lever Ponds plans to outsource a large number of its products in the near future. As a large number of products are to be outsourced, internal controls need to be tightened to avoid inaccurate reporting, wastage and low quality standards and possible increase in costs.

The results of the research will be made available to the Lever Ponds Third Party Management Team in the form of a report.

## **CHAPTER 4**

### **4.1. FINDINGS OF STUDY**

#### **4.1.2. LEVER PONDS**

Various staff members that work in the departments that are part of the Third Party Manufacturing team (Third party accounts, Planning, Quality Assurance and Factory Human Resources) were party of the study.

The researcher made appointments with the selected staff members and requested them to answer questions from the questionnaire attached as (Appendix one). After the questions in the questionnaire had been answered, a short unstructured interview was conducted. Each respondent was asked to tell the researcher any additional information and concerns they had about the outsourcing process.

#### **4.1.3. OUTSOURCING COMPANIES**

As mentioned earlier, the researcher conducted the research at three outsourcing companies used by the Maydon Wharf plant. Quality Products in Jacobs, Paccon Research in Queensmead and Kelly Foods in Northmead were visited. At Quality Products, the Production manager, Plant Foreman, assistant accountant and laboratory technician were part of the study. At Paccon Research, the researcher met the Director, who also plays a liaison role between Paccon Research and Lever Ponds. Telephonic interviews were held with the assistant accountant and laboratory technician. At Kelly Foods, the researcher personally interviewed the Director and Quality

Assurance Manager. As in the case of Paccon Research, telephonic interviews were held with the assistant accountant and laboratory technician.

In this chapter, the findings of the research will be represented by means of figures and a brief overview of the findings will be done. A detailed discussion of the findings with possible reasons will be done in the following chapter.

The following tables will give the numerical data of the findings of the research:

The biographical data of the research is outlined below:

**Table 1**  
**Section A - Demographic Data**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
<b>Gender</b>				
Male	7	83%	11	92%
Female	1	17%	1	8%
<b>Age Group</b>				
18-25yrs			1	8%
26-33yrs	1	17%	1	8%
34-41yrs	3	33%	2	17%
42yrs & above	4	50%	8	67%
<b>Marital Status</b>				
Never married	1	17%	1	8%
Married	7	83%	11	92%

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
<b>Highest qualification</b>				
Cerificate	4	50%	1	7%
Diploma			5	42%
Degree	1	16%	6	50%
Post grad	3	33%		
<b>Department</b>				
Planning	2	33%		
Accounts	4	50%	3	25%
QA	1	10%	9	75%
HR	1	7%	0	
<b>Years of service</b>				
2-5yrs	1	17%	6	50%
6-10yrs			2	17%
11 yrs & more	7	83%	4	33%
<b>Company designation</b>				
Manager	4	50%	6	50%
Assistant	3	33%	6	50%
Clerk	1	17%		

The section on demographic data was to assist the researcher to gather more information about the respondents. From the information in this section, the researcher was able to get a greater understanding and insight into the respondent's answers. For example, most of the respondents that worked in departments other than Quality Assurance gave a "do not know" response when they were asked, "since the outsourcing of core products to outsourcing products to outsourcing companies, to your knowledge, has there been an increase in customer complaints?" respondents that worked in the Quality

Assurance Department were able to give more information, as the question related to the work they ordinarily do.

In the case of outsourcing companies, the years of service relates to the number of years the respondent has been at the outsourcing company. Most of the outsourcing companies used by the Maydon Wharf factory are companies that have recently been formed (most, with the exception of Quality Products are not older than ten years).

## **Section B – Outsourcing Services**

### **Question 1**

Assess each of the following, from 1 to 5, in terms of their importance, as advantages. For example, if you feel meeting production targets is a very important advantage of outsourcing, then put 5 in the appropriate box. If you consider it as mildly important, then put 3. If you consider it a very unimportant advantage of outsourcing, then put 1 in the appropriate box. There is no right or wrong answer, so please indicate what you really think.



Table 2  
 Section B-Advantages of outsourcing production

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
<b>Meeting production demands</b>				
Very important	4	50%	8	67%
Important	3	33%	3	25%
Mildly important	1	17%	1	8%
<b>Time and resources concentrated on core products</b>				
Very important	4	50%	12	100%
Important	2	28%		
Mildly important	1	17%		
<b>Lowering of production costs</b>				
Very important			11	91%
Mildly important			1	9%
Unimportant	8	100%		
<b>Availability of specialised Machinery</b>				
Very important	4	50%	7	58%
Mildly important	1	16%	3	25%
Unimportant	3	34%	2	17%
<b>Other-flexibility of outsourcing company</b>				
Very important	3	33%	8	67%
Mildly important			4	33%
Unimportant				

This question assisted the researcher to find out what the respondents felt were the important advantages in outsourcing production. The respondents from Lever Ponds and the outsourcing companies had similar sentiments about the advantages of outsourcing.

**Question 2**

Assess each of the following, from 1 to 5, in terms of the obstacles inherent in conducting business with 3<sup>rd</sup> parties. For example, if you feel that stock shortages in the most common problem in conducting business with 3<sup>rd</sup> parties, then put 5 in the appropriate box. If stock shortages are not a serious problem, then put 3. If stock shortages are not a problem at all, then put 1. There is no right or wrong answer, so please indicate what you really think.

**Table 3**

**Section B - Obstacles in conducting business with 3<sup>rd</sup> parties**

Obstacle	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
<b>Stock shortages</b>				
Very important	2	20%		
Unimportant	6	80%	10	83%
<b>Weaknesses in Quality Control</b>				
Very important	2	20%		
Unimportant	6	80%	10	83%
<b>Timeous deliveries</b>				
Very important	2	20%		
Unimportant	6	80%	10	83%
<b>Wastage and pilferage of Stock</b>				
Very important	2	20%		
Unimportant	6	80%	10	83%
<b>Unfamiliarity with LP Production methods</b>				
Very important	2	20%		
Unimportant	6	80%	10	83%

This question assisted the researcher to find out what the respondents felt were the inherent obstacles in outsourcing production. The results from Lever Ponds and outsourcing company respondents are relatively the same, with the difference in scores being for communication breakdowns.

**Question 3**

Assess each of the following from 1 to 5, as weakness that may have an impact on the 3<sup>rd</sup> party process

**Table 4**

**Section B - weakness**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
Ordering system Unimportant	8	100%	12	100%
Collection of raw materials from LP to 3rd Party Unimportant	8	100%	12	100%
Delivery of raw materials Unimportant	8	100%	12	100%
Payment procedures Very important Unimportant	8	100%	12	100%
Other-trust, honesty Very important			4	33%

The results are comparable, except for payment procedure, which the Lever Ponds respondents have viewed as unimportant and the outsourcing companies as very important. This is so, because the outsourcing companies

rely on Lever Ponds payment. If the payment is not the same amount as planned, due to some invoices being blocked, this creates problems for them, as they were anticipating receiving a higher amount and thus budgeted with this amount in mind.

**Question 4**

Since the outsourcing of core products to outsourcing companies, to your knowledge, has there been an increase in customer complaints?

**Table 5**

**Section B - increases in customer complaints**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
<b>Increases in customer Complaints</b>				
Yes	1	17%		
No	4	50%	9	75%
Don't know	3	33%	3	25%

At Lever Ponds, the respondents that did not work in the Quality Control Department were not aware of the number of production faults that had been found in products that had been manufactured at outsourcing companies. In cases where the problem had a created a stir, (amount of time spent to correct the fault, costs involved and complaints from the trade), the respondent was aware of the problem, but lacked specific details. The Planners at Lever Ponds were aware of the problem in terms of amount of

stock to be written off and recalled, but the information that came to mind was concentrated to their own specific brands and not the wider picture.

Assess the following customer complaints from 1 to 5, with 5 being a very frequent and 1 a very infrequent complaint.

**Table 6**

**Section B - complaints**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
<b>Poor quality of product</b>				
Unimportant	1	16%	3	25%
No response	7	84%	9	75%
<b>Faulty nozzles</b>				
Unimportant	1	16%	3	25%
No response	7	84%	9	75%
<b>Faulty caps</b>				
Unimportant	1	16%	3	25%
No response	7	84%	9	75%
<b>Other (specify)</b>				
Unimportant	1	16%	3	25%
No response	7	84%	9	75%

The respondents at Lever Ponds stated that the issues raised by customers for products manufactured at outsourcing companies were the same as those received for products manufactured at the Lever Ponds factory. Most customer complaints related to design and packaging. Complaints relating

directly to the product, such as formulation were also received. The outsourcing companies' respondents felt that it is not likely that a customer complaint will be received from their batches of production, as a sample of each batch was checked by Lever Ponds Quality Assurance Department, before products were sent to the trade. In cases where there was a high demand for a product, products were sent to distribution centers without being checked by Lever Ponds Quality Assurance Department, in this scenario, it was possible to get customer complaints.

**Question 5**

What costs have risen as a result of outsourcing?

In each case indicate the extent to which you consider each aspect to have contributed to the rise in costs through outsourcing. Allocate 1 if you feel the rise in costs as being small or negligible and 5 if you feel the rise in costs as being considerable.

**Table 7**

**Section B - increase in costs**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
<b>Increase in product prices</b>				
Very important	7	83%		
Unimportant	1	17%	12	100%

Table 7 continued				
<b>Costs of reworking workmanship</b>				
Very important	7	83%	5	40%
Unimportant	1	17%	7	60%
<b>Loss of direct relationship with suppliers</b>				
Very important	7	83%	10	80%
Unimportant	1	17%	2	20%
<b>Loss of personnel as a result of operations ceasing</b>				
Very important	7	83%	10	80%
Unimportant	1	17%	2	20%
<b>Increase in transport</b>				
Very important	7	83%		
Unimportant	1	17%	12	100%

The scores between respondents from Lever Ponds and outsourcing companies differ for the following reasons:

1. There are products that are ordinarily made at outsourcing companies.

These are non- core products. For such products the cost of raw and packaging materials, third party conversion cost and transport is combined to yield a final price for the products. For core products, (products made in house, at the Maydon Wharf factory) costs such as third party conversion cost and transport are not budgeted for.

Manufacturing core products at outsourcing companies as a contingency measure increases product prices, as contingency production has not been budgeted for. On the other hand, the increase in product prices will not

be a cost that the outsourcing company has to bear, as they would have received business in the form of contingency production.

2. Due to outsourcing contingency production as in (1.) above, there will be an increase in transportation costs.
3. The outsourcing companies' attitude to an increase in costs due to outsourcing contingency production is that Lever Ponds would have a higher cost to bear - in terms of lost sales and dissatisfied customers if stock was not available for resale. With this view in mind, the outsourcing company is of the opinion that it is cheaper to produce products at outsourcing companies than to have no stock available for customers.

**Question 6**

What costs have decreased as a result of outsourcing?

In each case indicate the extent to which you consider each aspect to have contributed to the decrease in costs through outsourcing. Allocate 1 if you feel the decrease in costs as being small or negligible and 5 if you feel the decrease in costs as being considerable.

**Table 8**

**Section B - decrease in costs**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
Factory overheads Very important	8	100%	12	100%



<b>Table 8 continued</b>				
<b>Costs of buying and maintaining specialised machinery</b>				
Very important	7	83%	12	100%
No response	1	17%		
<b>Salaries</b>				
Very important	6	80%	12	100%
No response	2	20%		
<b>Costs associated with critical stocks</b>				
Very important	5	60%	12	100%
Midly important	1	20%		
Unimportant	1	20%		

The scores yield the same sentiments from both Lever Ponds and outsourcing companies' respondents. Cognisance should be made of the fact that the issue of contingency production was highlighted yet again by the Lever Ponds respondents. As the costs of contingency production are not budgeted for, there is a sentiment that it is accepted that costs associated with contingency production are higher.

The Lever Ponds respondents are of the opinion that it is cheaper to manufacture a product in house at the Lever Ponds factory, rather than at an outsourcing company. This is due to the Maydon Wharf factory having specialised machinery, automated production methods and high speed run times. The use of outsourcing companies is useful for the following reasons:-

1. The product has several variants (size and formulation) and the volume of units produced is not high. To change the formulation and size for the various brands means changing production of the formulation and the

machines in order to cater for the different weights and measurements. This process takes time and can lead to line stoppages, which means very expensive production time lost. In such cases, outsourcing the production of such a product is the best alternative.

2. Testing the market- test to see how the product fairs in the market, in terms of the sales levels and how sustainable they are. If the sales levels are favourable and the Maydon Wharf factory has the appropriate machinery, then the product may be made in house.
3. Change in consumer tastes and the need to innovate. Consumer tastes may change, given different trends and styles. Before a product is made in house and investment in capital equipment is made, the business should be confident that a new trend and style will not come about very soon, so as to make the old product outdated.

**Section C-Outsourcing Services**

**Question 1**

Have there been financial losses as a result of outsourcing?

**Table 9**

**Section C- financial losses**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
Financial losses				
Yes	1	16%		
No	7	84%	8	67%
Don't know			4	33%

The respondents from Lever Ponds noted that financial losses are often not spoken about and details about the loss are kept confidential. The main problem about financial losses is that in most cases, the correct procedures to prevent the loss had not been followed.

A respondent from Lever Ponds remarked that “we hear that there has been a problem and somebody has done something that has cost the company a lot of money. There is talk of an investigation, then it is all quiet and swept under the carpet. We do not even know if the culprit is brought to book or what happens. One wonders if the money is ever recovered.”

**Question 2**

With the trend of using outsourcing companies set to continue:

- (i) Will Lever Ponds increase the number of suppliers?

**Table 10**

**Section C-increase in the number of suppliers**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
<b>Increase in number of suppliers</b>				
Yes	1	17%		
No	7	83%	11	91%
Don't know			1	9%

Both the Lever Ponds and outsourcing companies' respondents felt that the number of suppliers will not be increased as Lever Ponds has criteria and demands of a high standard. Smaller outsourcing companies would fail to meet Lever Ponds' specifications. The respondents that felt that Lever Ponds would increase the number of suppliers were of the opinion that Lever Ponds should engage the services of black empowerment companies, so as to be in line with industry trends.

(ii) Will existing outsourcing companies manufacture more products in the future?

**Table 11**  
**Section C-manufacture of more products**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
<b>Manufacture of more products</b>				
Yes	8	100%	12	100%
No				
Don't know				

All the respondents felt that the outsourcing companies will manufacture more products in the future, as Lever Ponds is a marketing company and as such will concentrate more of its efforts on marketing, research and development. The market environment is also changing drastically, so the flexibility of outsourcing companies will be an advantage in this regard.

**Question 3**

Do outsourcing companies improve their service delivery with time?

**Table 12**

**Section C- improvement of service delivery**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
Improvement of service delivery				
Yes	8	100%	12	100%
No				
Don't know				

Respondents from Lever Ponds as well as the outsourcing companies felt that outsourcing companies get familiar with the production process, communication with suppliers, Lever Ponds and other stakeholders the longer they do business with Lever Ponds.

**Question 4**

On a comparative basis, is it cheaper to produce a product at the Lever Ponds factory or at an outsourcing company?

**Table 13**

**Section C-cost of production**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
Cost of production				
Yes	8	100%	12	100%
No				
Don't know				

All the respondents felt that if the product is a non- core product (usually produced at an outsourcing company), then it is cheaper to produce it at an outsourcing company than at the Maydon Wharf factory. Producing core products at outsourcing companies meant an increase in cost, as a premium was paid on contingency production.

**Question 5**

In your view, has the outsourcing strategy adopted been successful?

**Table 14**

**Section C- has outsourcing strategy been a success?**

Details	Frequency- Lever Ponds		Frequency- Outsourcing company	
	Number	Percentage	Number	Percentage
Has outsourcing strategy been a success?				
Yes	8	100%	12	100%
No				
Don't know				

All the respondents felt that the outsourcing strategy had been a success. One respondent remarked that what seemed to be problems and obstacles could be avoided and overcome if all parties involved in the outsourcing process adhered to stipulated policies and procedures.

**5. CONCLUSION**

This chapter gave an analysis of the results of the study. A brief overview of the results was also given. The results will be discussed in detail in Chapter five.

## **CHAPTER FIVE**

### **5. DISCUSSION OF THE FINDINGS**

The aim of this chapter is to discuss the findings of the results outlined in Chapter four

#### **5.1 Section A - Demographic Data**

##### **5.1.1. Gender**

Most of the respondents (88%) are males. This is so, as the positions occupied by the respondents are males. This is understandable, as the Third Party Manufacturing department is predominantly male dominated.

##### **5.1.2. Age Group**

Half of the respondents (50%) are in the 42 years and above category. Most of the respondents from the outsourcing companies are former Lever Ponds employees that are now based at the outsourcing companies. Most of the older respondents from outsourcing companies had a long service with Lever Ponds before moving on to the outsourcing companies. Due to this, they know a large number of people in many departments and are familiar with the Lever Ponds structure and manner of operation. The age of the respondents also shows that they have a wealth of experience and know how due to their long working experience.

##### **5.1.3. Marital status**

A large number of the respondents (88%) are married.

#### **5.1.4. Highest qualification**

Most of the respondents have degrees (33%), followed by certificates (28%) and diplomas (21%). A small number of the respondents (17%) have post-graduate qualifications.

#### **5.1.5. Department - Lever Ponds**

As stated earlier, the departments that are part of the Third Party Manufacturing structure at Lever Ponds were part of the study. Attempts were made to interview all the people in each department that has links with outsourcing companies. Most of the respondents that were earmarked for the study actually participated. Three Lever Ponds employees that were also part of the target group declined to participate in the study due to work pressure at the time.

#### **5.1.6. Department - outsourcing companies**

The manner of selecting the respondents at the outsourcing companies was done in the same manner as Lever Ponds.

#### **5.1.7. Years of service**

As mentioned earlier, for the respondents at the outsourcing companies, the number of years of service was determined by how long the outsourcing company had been in existence. For the years of service prior to this, most of the older respondents had been based at Lever Ponds. Most outsourcing companies (with the exception of Quality Products) are younger than ten years. In the study, Kelly Foods has been in operation for eight years and Paccon Research for four years.



In the case of Lever Ponds, most of the respondents had long years of service within the company and most had worked in the Third Party Manufacturing Department for approximately five years (when the Department was seen as a fully fledged department).

#### **5.1.8. Company designation**

The researcher aimed to get responses from management as well as staff. In the case of Lever Ponds this was achieved. In the case of outsourcing companies, it was only possible to visit the management teams due to time constraints. Telephonic interviews were conducted with the staff.

### **5.2 Section B**

#### **5.2.1. Question 1**

In question 1, the respondents were requested to assess the advantages of outsourcing production to outsourcing companies. Meeting production demands is considered an important advantage of outsourcing by (50%) of the Lever Ponds respondents and (67%) of the outsourcing companies' respondents. The Lever Ponds respondents stated that meeting production demands was crucial in the case of contingency production (when the factory is unable to cope with in house production demands and contracts outsourcing companies). The cost of the factory failing to produce planned demand will be a loss of sales, as customers will opt for competitors' products, if the Lever Ponds products are unavailable to the trade.

In the case of Lever Ponds, (50%) of the respondents and in the case of outsourcing companies, all the respondents felt that outsourcing gave Lever

Ponds the time and resources to concentrate its efforts on core competencies. Concentrating on core competencies would mean that Lever Ponds would allocate more effort and time to marketing and development, (Lever Ponds core competencies). This would mean that the Maydon Wharf factory would concentrate on producing core products only. Products that do not yield high production and sales volumes would be made at outsourcing companies, so that the factory has the capacity to concentrate on producing products that yield high sales and ultimately high profits.

The availability of specialised machinery at outsourcing companies was considered an advantage of outsourcing by (50%) of respondents from Lever Ponds and (58%) respondents from outsourcing companies. The rationale behind this thinking is that a product that needs a degree of differentiation (for example beads in body wash); would take a large amount of production time for the correct machinery to be set up, formulation to be changed and batch to be produced. In such instances, if the outsourcing company has the specialised machinery to make the beaded variant, then it will be easier and cheaper to produce it there, as there will be no production time lost. Further to this, for minor changes to products, for example imported products that need to be modified to suit the South African market, it would be costly in terms of production time to do these changes in house at the Maydon Wharf factory. Such changes are done quickly and cheaply at the outsourcing companies.

The lowering of production costs was not considered as an important advantage of outsourcing production by all Lever Ponds employees, whilst (91%) of the outsourcing companies considered costs as an important

element of outsourcing. The Lever Ponds respondents were of the opinion that although costs were important, other factors such as quality, expertise and costing methods have to be considered in relation to costs. A respondent from Lever Ponds stated that " a cheap quote may mean differences in pricing. One supplier may quote in tons and the other in cases, which may lead to vast differences to prices; so one needs to be careful to use the same bench marks for costs."

The Lever Ponds respondents further stated that, due to Lever Ponds having automated production systems, world class- supply chain mechanisms and skilled staff, this made production of a product in house cheaper than at an outsourcing company. Further to this, the outsourcing company will charge Lever Ponds conversion costs, which will add to the cost of the product. The Lever Ponds respondents felt that the Lever Ponds outsourcing strategy did consider costs, but adopted a holistic approach, (which included potential lost production time, economic and labour issues), so that the cost impact was not that significant overall.

On the other hand, the outsourcing companies felt that costs were important, as due to outsourcing, Lever Ponds saved on production costs such as direct labour, factory overheads and lost production time. Direct labour costs will decrease, as due to outsourcing, work stations that are no longer operational are shut down, production time lost is minimised, as there are fewer production lines, thus the need for changing machines to accommodate different products and variants is avoided. The outsourcing company has a permanent labour pool, but in cases of increased production, due to higher orders from Lever Ponds, the services of a labour broker are employed, in the case of Quality Products and Paccon Research. Should the need arise,

the staff also work overtime. In the case of Kelly Foods, temporary labour is obtained from referrals, in most cases, family members of permanent staff. As in the case with Quality Products and Paccon Research, staff may be required to work overtime. The outsourcing companies feel that a flexible labour pool saves them a large amount of money, as they employ as and when the need arises and they do not have to bear any additional employment costs. Further to this, there are limited labour problems, as the temporary staff labour pool is not unionised.

The availability of specialised machinery is considered an important advantage of outsourcing by (50%) and (58%) of the respondents of Lever Ponds and the outsourcing companies respectively. As stated earlier, the outsourcing company may have specialised machinery to make a different variant for a product or to make a differently shaped packaging design. Such small modifications may take up a large amount of production time at the Lever Ponds factory, so outsourcing is considered a cheaper option. Examples of specialised machinery are a machine that makes a beaded form of body wash at Kelly Foods, one that makes a differently shaped roll on at Paccon Research and one that gives a design to the edge of packaging material at Quality Products. As the production of products that need modification is outsourced most of the time, Lever Ponds can save on the investment of specialised machinery, thus lowering working capital costs.

Most of the respondents of the outsourcing companies, (67%) stated that their flexibility made them an important element in the Lever Ponds supply chain. Their core competency is to be flexible and tailor their production schedules to provide the service that Lever Ponds requires; due to this, they were able to change their manner of operation to deliver to Lever Ponds

specifications. A respondent from the outsourcing company made it clear that "we do everything in our power to satisfy our customers, as our flexibility is our core competence and that is how we stay competitive."

Some of the respondents at Lever Ponds stated that the outsourcing companies had the services of consultants and experts at the disposal, due to the diverse nature of their work, due to this, it was possible to get advice in areas where problems arose. Further to this, an advantage of having a number of outsourcing companies from which to choose from meant that there could be comparison of prices and wider pool from which to choose the best suppliers, which led to increased competition among outsourcing companies and thus lower costs.

#### 5.2.2. Question 2

In question two, the respondents were requested to state what they felt were the inherent obstacles with conducting business with outsourcing companies. The respondents stated that:

1. stock shortages
2. weaknesses in quality control
3. timeous deliveries
4. wastage and pilferage of stock
5. unfamiliarity with Lever Ponds production methods

were unimportant obstacles in conducting business with outsourcing companies for the following reasons:

1. Stock counts should be conducted monthly at the outsourcing companies. In most cases, the third party planners conduct the stock counts. Stock counts are conducted at the Lever Ponds factory at every month end. Due to this, there is a check on the amount of stock sent to the outsourcing company vs the amount of stock actually at hand on the outsourcing companies' shop floor.
2. Before a new product is manufactured at the outsourcing company, Lever Ponds Quality Assurance Department staff provide training to the outsourcing companies' staff for specifications such as formulation of the product and packaging. There is daily communication between the Quality Assurance staff at Lever Ponds as well as the outsourcing companies. Samples made at the outsourcing company are sent to Lever Ponds for checking and scrutinizing before a production batch manufactured at the outsourcing company is released to the trade.
3. The reliable and timely delivery of stock between the outsourcing company and Lever Ponds is achieved by Lever Ponds having a dedicated logistics company to do their deliveries and collections; as the entire supply chain of Lever Ponds has been contracted to a dedicated supplier. Outsourcing the logistics function has lead to decreases in delivery and collection delays. Samples from outsourcing companies are also delivered to Lever Ponds on a daily basis by a dedicated courier company.
4. Further to this, there is a production and delivery schedule for finished goods from the outsourcing companies to Lever Ponds. Due to the frequent communication between the Development, Planning and Quality Control Departments at Lever Ponds and the outsourcing company,

relevant parties are kept informed as whether the outsourcing company will be able to meet planned production deadlines. In the event of the outsourcing company not being able to meet deadlines, a contingency measure, (for example transferring some of the production units to another outsourcing company or employees working overtime) is investigated.

5. Due to the points outlined above, both the respondents from Lever Ponds and the outsourcing companies felt that the factors mentioned do not cause obstacles to the outsourcing process. Respondents from Lever Ponds felt that the policies and procedures are in place, staff at Lever Ponds as well as the outsourcing companies must adhere to them. Should the correct procedures be followed, then the possibility of problems arising will be minimised.
6. The respondents differed with the issue of communication breakdowns. All the Lever Ponds employees did not consider communication breakdowns as an obstacle to outsourcing. Respondents at outsourcing companies (83%) felt that at times the staff at Lever Ponds came across as arrogant and not sympathetic to the problems that they faced as smaller concerns. Areas raised by the outsourcing companies were:
  - (a) Budget constraints - Lever Ponds expects the outsourcing companies to have the same level of technology and sophisticated production methods as they do. Due to their limited budgets, outsourcing companies cannot always meet Lever Ponds demands for improved machinery.

- (b) Cash flow problems - Lever Ponds does not always understand that the outsourcing companies plan around payment for a stipulated amount from Lever Ponds. Should Lever Ponds pay less than the stipulated amount due to administrative factors, then this has an adverse effect on the outsourcing companies' cash flow.
- (c) Production demands-Lever Ponds may at times present the outsourcing companies with very high orders to be manufactured within a short period of time. Due to the size of the outsourcing companies, increasing the capacity of the production lines would cause a decline in production standards and glitches to the production line. At times, the outsourcing company may state that they are unable to honour the orders. Lever Ponds has come across as having an attitude of "if you cannot do it, we will find someone else who will." Outsourcing companies also get pressured into concentrating on Lever Ponds production, so as to maintain them as a valued customer.
- (d) Problems with documentation, for example, delivery notes and purchase orders. This was highlighted by a large number of the respondents that work at the outsourcing companies accounts department. The respondent's main concern was that documentation from Lever Ponds often arrived at their premises late and this caused delays in payment to Lever Ponds. In some instances, documentation had not been signed and this caused delays; as investigations had to be done before payment could be made. A respondent stated that "the documentation issue is a big problem, as you move backwards and forwards, between Lever Ponds and the supplier, trying to trace the correct information. When you finally receive the documentation, in



some cases invoices numbers do not correspond to order dates, so this further causes delays to payments and it takes a long time to match invoices in time for month end cut offs."

### 5.2.3 QUESTION 3

In question three, the respondents were asked to assess which weaknesses may have an impact on the outsourcing process. The respondents had to consider the ordering system, collection and delivery of raw materials from Lever Ponds to outsourcing company and payment procedure.

In all instances, the respondents did not feel the factors mentioned above were weaknesses that had an impact on the outsourcing process. All the respondents also stated that policies and procedures were in place that prevented any flaws to the outsourcing process. Problems arose when the policies and procedures were violated due to human error.

As mentioned earlier, Lever Ponds has contracted its entire Logistics Department to a dedicated service provider, (Tibbet and Britten). Due to this, delivery of materials and finished goods from the outsourcing company to Lever Ponds and vice versa is easy and very fast, reducing the problems of stock losses and stock being delivered and collected late. According to Goolsby, (2003), most successful outsourcing companies extend their contracts to include logistics and warehousing services. Although the outsourcing companies that Lever Ponds contracts to do not have a dedicated logistics provider, Lever Ponds does and has included deliveries and collections from outsourcing companies in the contract.

The respondents from Lever Ponds and the outsourcing companies had vastly different scores when it came to the payment procedure. All the respondents from Lever Ponds stated that payment procedures were unimportant, whereas all the outsourcing companies' respondents felt that they were very important. As mentioned earlier, the outsourcing companies rely on Lever Ponds payment. Their accounting departments assess how much money Lever Ponds will be paying them by a certain date and they plan their cash forecasts and payments to third parties based on this information. In the event of the outsourcing companies' invoices being rejected for payment, they are paid less than they anticipated and this affects their cash flows. Outsourcing companies feel that the Lever Ponds staff is not always proactive in avoiding the administrative backlogs that cause invoices to be rejected. Further to this, all the outsourcing companies that were interviewed stated that they delivered documentation personally or used couriers in order to avoid postal delays.

The Lever Ponds respondents stated that they try to avoid administrative backlogs, but in some instances the outsourcing companies did not supply necessary information on time, with the result that queries remain unresolved for long periods. Further to this, outsourcing companies also delayed in paying Lever Ponds for raw materials purchased. Lever Ponds does enforce a policy of co-operation and understanding in terms of receiving payment from outsourcing companies, some outsourcing companies have abused this. When the outsourcing company does not pay Lever Ponds for outstanding invoices, then the outsourcing companies account is frozen, as they are considered as a bad debt risk. In instances where this action has occurred, the management of the outsourcing company and Lever Ponds have

held meetings with a view of solving the problems. In most instances, suitable payment terms have been agreed on. In cases where there has been a large quantity of unpaid raw materials stock at the outsourcing company, plans have been formalised as to when the stock will be converted and subsequently paid for. Should the outsourcing company state that some of the stock is obsolete, Lever Ponds will destroy it and write it off. Stock that cannot be converted by the outsourcing company is returned to Lever Ponds and the outsourcing company credited for the return. The Lever Ponds respondents felt that they tried to apply a sympathetic attitude towards the outsourcing company in such issues. Decisions taken were seen to be beneficial to both the outsourcing company and Lever Ponds. Lever Ponds respondents stated that outsourcing companies need to get assistance in financial matters, as most of them lacked the know-how of cash flow control. Most of them ran their cash flow on a day to day basis, with little, if any forecast for future months.

A small number of respondents from Lever Ponds (33%) stated that factors such as honesty and integrity have a major part to play as weaknesses in the outsourcing process. The relationship between Lever Ponds, the outsourcing company and suppliers may be open to fraud and corruption, as there are large sums of money involved. Corporate policies outline instances that could constitute fraud and corruption, the onus is on the individual to uphold the policies.

#### 5.2.4 QUESTION FOUR

In question four, the respondents had to state whether or not there was an increase in customer complaints due to outsourcing. Half of the Lever Ponds

respondents stated that there had been no increase in customer complaints. Some of the respondents (75%) from the outsourcing companies were of the opinion that there was no increase in customer complaints.

A small number of the respondents from Lever Ponds (17%) said that there had been an increase in customer complaints, but these complaints were the same as complaints being received about products that were manufactured in house at the Lever Ponds factory. Most complaints related to design of the packaging, dirty labels and products having no codes on stickers. Lever Ponds respondents felt that their quality control system was very stringent in checking every sample for each batch produced, before products were released to the trade. In the event of a sample failing the quality assurance checks, then the entire batch is rejected even before it leaves the outsourcing company. Complaints relating to items such as faulty nozzles and caps were received, but on a small scale, when one considers the volume of products manufactured. There is a dedicated customer service department that keeps a record of customer complaints. Each complaint is treated with extreme importance, so as to retain the customer. A respondent that works at the Lever Ponds Quality Assurance Department stated that "each customer complaint is treated with great importance, no complaint is ever considered small or petty. A dissatisfied customer can stop buying our products and spread the word to others, so we try to do everything to investigate and resolve every customer complaint."

The Lever Ponds respondents felt that the outsourcing companies should be commended on the quality of their products, as the machinery used at outsourcing companies is less automated than at the Lever Ponds factory. As the machinery is less automated, products are more prone to human error.

The production speeds of machinery at the outsourcing companies are also far slower than at the Lever Ponds factory. A quote from a Lever Ponds respondent is that "the third parties do a good job if you consider that their machines are more manual than ours and they run at much slower speeds. Despite this, the complaints that we get from customers are the same as we get from our very own factories."

Most of the respondents at the outsourcing companies felt that there was no increase in customer complaints, as before a batch was released to the trade, the Lever Ponds Quality Assurance Department had already checked samples. There may be an increase in customer complaints when there is a time constraint and there is a high demand for a certain product. In such cases, some batches are released to the trade without the Lever Ponds Quality Assurance Department testing them.

Some of the outsourcing companies are of the opinion that they have been producing Lever Ponds products for a considerable length of time and as such, the testing of samples by Lever Ponds is an unnecessary procedure that wastes time and causes production backlogs. Due to the time it takes to take the samples to Lever Ponds, checking them, then waiting for the quality control staff to give authorisation for the batch to be taken from the outsourcing company to the Lever Ponds warehouse, production is affected adversely. This is so, as new batches are not manufactured until Lever Ponds has given approval for the batch that is being tested. The outsourcing company feels that Lever Ponds should have more confidence in their production and quality standards, as other companies that use their services do not require that samples be sent to them before they are released to the trade. The outsourcing companies stated that they have

their own suitably qualified laboratory technicians that could perform testing and quality control procedures on site, which would assist to prevent the loss of valuable production time.

A respondent from an outsourcing company stated that "we have been producing for Lever Ponds for a long time and we also produce for other large customers and they have more trust in us than Lever Ponds does." Lever Ponds is the only customer that requires us to send their samples to their lab for testing. This causes a big problem to our production schedule, as we end up squeezed for space and production is affected."

#### 5.2.5 Question 5

The question requested the respondents to state which costs had risen as a result of outsourcing. Please refer to Figure 1 for a diagrammatic representation of the findings.

In the question that asked the respondents whether or not there had been an increase in:

1. Product prices
2. Costs of reworking workmanship
3. Loss of direct relationship with suppliers
4. Loss of personnel as a result of operations ceasing
5. Increase in costs such as transportation and handling.

The majority (83%) of the Lever Ponds respondents stated that there had been an increase in all the factors mentioned above due to outsourcing. Most of the respondents from the outsourcing companies stated there had been

no increase in the points mentioned above. As been stated in chapter four, the issue of contingency production (production normally done at the factory, but done at outsourcing companies due to capacity constraints) needs to be considered when costs are to be assessed.



















Contingency production may arise due to the following reasons:

1. Capacity constraint at Lever Ponds factory, this may be due to production time lost due to faulty machinery, power failures and maintenance related problems.
2. Economic factors - due to exchange rate differences between South Africa and overseas countries, it is profitable for Lever Ponds South Africa to supply products to countries with a lower exchange rate than South Africa. Due to this, the demand for a specific product may increase, necessitating the use of outsourcing companies. The demand for products also increases tremendously before a price increase takes place. The trade will stock up on products, increasing demand.
3. Political factors - the labour force may embark on strike actions or go slows as a form of protest action.
4. Seasonal fluctuations - the Production Department may stock pile due seasonal changes, for example in the months prior to winter, a high volume of lotions are manufactured at outsourcing companies, as a high demand is expected during the winter months.

The Lever Ponds respondents are of the opinion that the costs incurred in outsourcing contingency should be assessed for reasonableness. For example,

# ANALYSIS:PERCEPTIONS OF STAFF AT OUTSOURCING COMPANIES AND LEVER PONDS

Figure 1

Detail	Base measure		Outsourcing Company	Lever Ponds	Detail	Base measure		Outsourcing Company	Lever Ponds
<b>What leads to high costs in outsourcing?</b>					<b>Compliance to government and industry guidelines and requirements.</b>				
Increase in product price	10		1	8	ISO certification	10		8	10
Reworking faults	10		4	8	Skills Act and SETA registration	10		8	10
Loss of direct relationship with suppliers	10		8	8					
Loss of personnel	10		8	8					
Increase in transport and storage	10		1	8					
<b>Due to outsourcing which of the following costs are decreased?</b>					<b>Criteria for choosing outsourcing companies</b>				
Increase in factory overheads	10		10	10	Meets Lever Ponds standards and requirements	10		5	10
Buying specialised machinery	10		10	8	Cost	10		10	10
Salaries	10		10	8	Turnaround and delivery times	10		5	10
Costs associated with critical stocks	10		10	6	Capabilities	10		5	10
<b>Impact of prices on sales and profitability levels:</b>					<b>Perception of the staff regarding staff development, progression and advancement</b>				
Willingness to invest in new machinery, plant and equipment	10		7	10	Share option scheme, training and development	10		10	10
					Black economic empowerment deals	10		10	10

## Abbreviations:

LP - Lever Ponds

OS-outsourcing company

## Key:

Little consensus between OS and LP

Moderate consensus between OS and LP

Consensus between OS and LP





if the reason for outsourcing production is due to machinery not being operational, steps should be taken to take corrective action. Other factors such as seasonal fluctuations are unavoidable and in most cases, are planned for and anticipated.

Lever Ponds respondents felt that the cost of losing potential customers when products are not available is far more expensive than the cost of outsourcing production, so outsourcing contingency production should be considered in context of the wider picture, not just costs.

**ANAYSIS OF COSTS : IN HOUSE VS OUTSOURCED PRODUCTION**

**Figure 2**

Product	Outsourced Cost	In House Cost	Variance
A	89.81	63.54	(26.27)
B	13.98	10.68	(3.30)
C	14.38	11.01	(3.37)
D	13.73	10.57	(3.16)
E	13.53	10.40	(3.13)
F	13.62	10.50	(3.12)
G	13.26	11.49	(1.77)
H	13.31	11.28	(2.03)
I	18.39	15.91	(2.48)
J	16.54	16.07	(0.47)
K	17.31	14.72	(2.59)

Note : These products are in house products, meaning that they are ordinarily manufactured at the Lever Ponds factory. The outsourced cost refers to the amount Lever Ponds is / will be charged if the product is manufactured at an outsourcing company. The in house cost is the cost of manufacturing the product at the Lever Ponds factory.

Taking the information above into consideration, the premium Lever Ponds has to pay for outsourcing production is clearly visible. The cumulative effect of the figures above cause an increase to product cost, which significantly reduces the profit margins of the various products.

The information on page 69 related to soap that had to be produced at the outsourcing company due to capacity constraints at Lever Ponds factory. Product A's costs are significantly higher than the other products, as the outsourcing company will pay Lever Ponds for the raw materials. In the case of the other products, Lever Ponds supplies the raw materials, so the outsourcing company has only been contracted to perform a conversion function.

The costs relating to re-working workmanship were considered high by (83%) of the respondents from Lever Ponds and (40%) of the respondents from outsourcing companies. The respondents from Lever Ponds stated that re-working products was very costly and it is a lengthy process to assess who caused the fault. Further to this, the allocation of the costs to a specific department was problematic, as each department did not want to be disadvantaged, if the fault was due to a series of mistakes.

The respondents from outsourcing companies stated that most of the reworking costs that they have had to incur have been as a result of faulty formulations and specifications received from the Lever Ponds factory. They are of the opinion that due to their limited budgets, they try and prevent re-working as much as possible. Production staff is also constantly reminded that any wastage means a loss in profits. A respondent from the outsourcing companies stated that "last year there was a problem with a

formulation from Lever Ponds factory. Another outsourcing company was given the opportunity to manufacture the product and correct the fault. They failed to do so, so they brought it here to us, we succeeded to correct the fault, and held training sessions for the Lever Ponds staff, so that they could get their formulations right, so this proves that reworking is not always the outsourcing companies' fault."

A similar number of respondents at Lever Ponds and the outsourcing companies felt that the loss of a direct relationship with the supplier was a considerable cost in the outsourcing process. The Lever Ponds employees felt that at times suppliers may be prone to increasing their quotes to Lever Ponds, as Lever Ponds is known to be a large, profitable company. In instances where the outsourcing company has a direct relationship with the supplier, Lever Ponds may find it difficult to intervene in the relationship. This normally happens in the case of raw materials and packaging suppliers. In cases where suppliers are providing expensive materials and limited quantities, it is cheaper for Lever Ponds to have the outsourcing relationship with the supplier; as due to the large quantities Lever Ponds buys, the material may be available cheaper. Lever Ponds will also be in a better position to qualify for quantity discounts and negotiate for a lower price.

Lever Ponds respondents felt that the loss of personnel as a result of operations ceasing was a high cost in outsourcing. This is so, as when workstations are shut down due to outsourcing or the automation of production procedures, staff is re-skilled to be able to work in other areas, as per industrial stipulations. In the case of Lever Ponds, staff was given training in computer and business skills. Arrangements were also made to place the retrenched employees at outsourcing companies. After the

employees had received business skills training, some were awarded outsourcing contracts at the Lever Ponds factory. The aim of the business skills training is to enable the retrenched employees to be self-sustaining and establish their own businesses. Plans are currently underway to outsource other sections of the Lever Ponds factory to retrenched employees who have received the business skills training. The Lever Ponds management is of the opinion that it is better to award outsourcing contracts to trained retrenched employees, as such employees are familiar with the Lever Ponds procedures and they also know a large number of people.

Most of the respondents from the outsourcing companies were of the opinion that Lever Ponds was saving a considerable amount of their wage bill by outsourcing their operations. The outsourcing companies felt that since they contract the services of labour brokers, their workforce is flexible and available as and when a need arises.

As has been mentioned earlier, the outsourcing companies do not face many personnel problems, as they have a permanent workforce and employ the services of a labour broker if there is any increase in production, which needs more labour. Temporary labour does not present inherent labour problems such as union issues and the need to pay for medical aid and provident fund benefits.

Also, as outsourcing companies are small concerns, they pay the stipulated industry wage rate. Lever Ponds, as a multinational company pays above the stipulated rate, and as such has a high wage bill. Quality Products, which is an outsourcing company as well as a Lever Ponds subsidiary feels

disadvantaged as it pays the same wage rates as Lever Ponds, which makes its labour expensive compared to the other outsourcing companies.

Lever Ponds employees may purchase Lever Ponds shares through a share option scheme. This is also the case at Quality Products, as Quality Products is part of the Lever Ponds group of companies. A share option scheme is also available at Kelly Foods. One of the members of the Kelly Foods management team remarked that "introducing a share option scheme has been very difficult, especially convincing some of our employees that this is now their business as well. It has been difficult to change the mindset of some of our employees."

Paccon Research has plans of engaging a black economic empowerment partner, so as to form a larger consortium. As mentioned before, Lever Ponds has plans of outsourcing sections of the production function to black economic empowerment companies. Most of the respondents from Lever Ponds as well as the outsourcing companies spoke favourably about forming partnerships with smaller concerns. Most of the Lever Ponds respondents stressed that the smaller concerns would not be given direct manufacturing jobs, but supportive ones, as they would not have the capacity to cope with Lever Ponds scale of production.

#### **5.2.6. Question six**

Please refer to figure one for a diagrammatic representation of the findings.

The question asked the respondents which costs had decreased as a result of outsourcing. Most the respondents from Lever Ponds as well as the

outsourcing companies felt that factory overheads, costs of buying specialised machinery, salaries and costs associated with critical stocks had decreased remarkably due to outsourcing.

The respondents felt that due to outsourcing, the cost of factory overheads (in the case of non- core production) had decreased as there was no machinery to be maintained and staff had been retrenched or moved to other work stations, so there was a saving in salaries. In the case of critical stocks, (60%) of the respondents from Lever Ponds felt that there had been a lowering of costs, but at times, the designated outsourcing company could not meet production schedules within the specified time, so production had been routed to other outsourcing companies.

### 5.3. SECTION C

#### 5.3.1. QUESTION 1

The question asked whether or not there had been any financial losses as a result of the outsourcing process. The majority of Lever Ponds and all the outsourcing companies' respondents replied that there had been no financial losses as a result of the outsourcing process. The Lever Ponds' respondents (16%) that felt that there had been financial losses as a result of outsourcing were of the opinion that there may be cases where Lever Ponds is at risk due to outsourcing their business to outsourcing companies.

Lever Ponds may be exposed to the following risks:

1. Suppliers and outsourcing companies colluding and over quoting prices.

2. Investing too much business in one outsourcing company. Risks may be heavy financial losses for Lever Ponds stock at the outsourcing companies' premises. Further to this, it may be difficult to contract another outsourcing company at short notice.
3. Adopting a strategy of awarding certain types of production to a designated outsourcing company, believing that they are the only ones capable of doing the job.
4. There are differences of opinion (between the Lever Ponds and outsourcing company respondents) as to how an outsourcing company is selected. Figure one shows the differences in perceptions among Lever Ponds and outsourcing company respondents' regarding turn around times, costs and capabilities as the criteria that determine whether or not an outsourcing contract will be awarded. There was an opinion between two of the outsourcing companies in the study that at times favouritism has been the overriding factor in awarding contracts. Some of the outsourcing company respondents felt that outsourcing companies that had lower quotes did not do the best job in most instances, as one respondent stated that "some companies just cut the corners to be awarded the contract, but their quality is questionable." Further to this, some of the outsourcing companies felt that Quality Products, due to its relationship with Lever Ponds had had an unfair advantage in securing business from Lever Ponds.
5. Outsourcing companies may not adhere to stipulated production standards.

In order to prevent the risks outlined above from taking place, Lever Ponds designed a third party outsourcing strategic plan during the early part of 2003. The plan outlines policies that state:

1. Outsourcing companies may not have Lever Ponds as their sole customer. Lever Ponds orders may not exceed 40% of their total order book.
2. Outsourcing companies may be assisted with start up costs, training and support (in the cases of black economic empowerment deals) for a stipulated period, at the end of five years, the outsourcing company should be independent of Lever Ponds and be able to tout for other business.
3. The outsourcing company should adopt an "open book" policy with Lever Ponds. Lever Ponds is to know the outsourcing companies' pricing structure and have access to quotes from suppliers and other pricing information. Lever Ponds should also have access to information such as which other parties the outsourcing company conducts business with.
4. The Third Party Department at Lever Ponds has employed three additional staff members, in order to be able to place more emphasis on improving outsourcing companies' standards of production and delivery levels. In the study, Lever Ponds and one of the outsourcing companies have already been granted ISO certification. One of the outsourcing companies is in the process of applying for ISO certification. (Please refer to Figure). All the companies in the study are au fait with the requirements of the Skills Act and all have staff training programs in place. Most of the respondents that participated in the study stated that they were pleased with the training programs at their place of work. The management of both Lever Ponds and the outsourcing companies' had an attitude of encouraging staff to improve their knowledge. One of the



respondents from Lever Ponds remarked that "innovation and change are happening all the time. We need to keep abreast with what is going on, so the only way we will do this is by constantly updating our knowledge."

### 5.3.2. Question 2

In this question, (83%) of Lever Ponds respondents and all the outsourcing companies' respondents stated that Lever Ponds would not increase the number of outsourcing companies that Lever Ponds awards contracts to. The main sentiment was that Lever Ponds' production standards and requirements are very high and as such, new outsourcing companies would not be able to satisfy established Lever Ponds criteria. There was a feeling among both Lever Ponds and outsourcing company respondents that Lever Ponds would award small scale outsourcing contracts such as packaging of finished goods and palletizing to black owned companies; but due to their size and inexperience in the production of products, manufacturing contracts would be denied.

A few of the Lever Ponds respondents (17%) stated that increasing the number of outsourcing companies would give Lever Ponds a wider pool to choose from and it would make the outsourcing companies more competitive in terms of lowering prices and offering better service levels.

### 5.3.3. Question 3

All the respondents from Lever Ponds and the outsourcing company were of the opinion that the service, turnaround times and quality of products produced improved with time. This was mainly due to the outsourcing

company gaining more experience and confidence in the production of Lever Ponds goods.

#### **5.3.4. Question 4**

The question asked whether or not it was cheaper to produce a product at the Lever Ponds factory or at an outsourcing company. All the respondents felt that if the product was a non-core product, producing it an outsourcing company was cheaper.

#### **5.3.5. Question 5**

All the respondents felt that the outsourcing strategy had been a success and as such, going to continue. The challenging facing Lever Ponds and the outsourcing companies is to establish working relationships that will improve the standards of the outsourcing process.

### **5.4. Conclusion**

This chapter gave a detailed analysis of the results obtained from Lever Ponds and outsourcing companies' respondents. The outsourcing strategy at Lever Ponds has been a success and is going to continue. Problems have arisen due to outsourcing companies:

1. experiencing cash flow problems

2. feeling that Lever Ponds is not understanding to the fact that they are smaller concerns and as such not able to invest in additional machinery
3. feeling that Lever Ponds standards and requirements are too high and at times, unreasonable.

Lever Ponds is of the opinion that outsourcing companies have been assisted with machinery, advice, training and an attitude of co-operation. The time has now come for the outsourcing companies to establish their own identity and be independent of Lever Ponds. Independence from Lever Ponds will assist the outsourcing companies to be awarded contracts from other companies and to grow their client base.

## **CHAPTER SIX**

### **SUMMARY AND RECOMMENDATIONS**

As mentioned in the previous chapter, respondents to the study have stated that the outsourcing strategy at Lever Ponds has been successful. The outsourcing companies and Lever Ponds agree that their relationship is going to continue for some time into the future, as both parties are mutually dependent.

The following factors have been identified as weakness to the outsourcing process:

1. Lever Ponds and the outsourcing companies have not always adhered to established policies and procedures. The policies and procedures may be ignored, only to be recalled when problems have arisen. In order to address the issue of policies and procedures, the Lever Ponds Third Party Department has employed additional staff members that will assist the outsourcing companies with issues such as quality control, specifications and house keeping rules. Further to this, the policies and procedures will assist with the collection of Lever Ponds cash from outsourcing companies, timeous payment of outsourcing companies and management of Lever Ponds stock at outsourcing companies premises.
2. The outsourcing companies feel that Lever Ponds does not have enough confidence in their operations. The outsourcing companies are of the opinion that they have been manufacturing Lever Ponds products for a long time and as such, processes such as taking samples to Lever Ponds for testing should be stopped.

3. At times, the relationship between the outsourcing companies and Lever Ponds has been strained. The outsourcing companies feel that due to its size and multi national status, Lever Ponds is arrogant. Lever Ponds states that they are understanding of the problems outsourcing companies face, but the outsourcing companies need to be more professional in their approach to business.
4. Both parties feel that there is a level of mistrust between them. This relates to the awarding of contracts, choosing of suppliers and pricing strategy. The outsourcing companies are of the opinion that Lever Ponds is at times wary that they are being manipulated and getting a poor bargain.
5. Outsourcing companies at times feel that they are not given the recognition they deserve. All the outsourcing companies in the study felt that in instances where Lever Ponds needed their assistance, especially during a crisis, there was reference to Lever Ponds and the outsourcing companies "being one big happy family that should help each other." In cases such as Lever Ponds requiring the outsourcing company to have improved production methods that required large injections of capital, Lever Ponds was not understanding to the cash flow problems smaller companies face. Further to this, the outsourcing companies felt that Lever Ponds expectations of the outsourcing company to comply with a specified factory layout, product specifications and certification by various bodies are too high for factories of their size and production capacity. One outsourcing company respondent stated that Lever Ponds was trying to make his outsourcing company " a mini Lever Ponds".

6. Lever Ponds is exposed to the following potential financial losses:-

- 6.1 Lever Ponds stock that is at the outsourcing companies' premises, but has not been paid for.
- 6.2 Possible collusion between outsourcing company and suppliers, so that prices are inflated.
- 6.3 The possibility of an outsourcing company being liquidated before its debts to Lever Ponds have been settled.

Policies and procedures outlined in the outsourcing strategic plan may prevent the above financial losses. The challenging facing Lever Ponds will be to adhere to the policies and procedures. The issue of the honesty and integrity of role players in the outsourcing process comes into play when the collusion between suppliers and outsourcing companies is discussed.

Unfortunately, Lever Ponds does not have control over possible collusion. Before a new outsourcing company is contracted, it would be advisable to do reference and credit checks, in order to determine the character of the outsourcing company.

- 7. The possibility of lower quality standards may be a potential risk for Lever Ponds, as consumers will not differentiate between a product manufactured at an outsourcing company and one manufactured at Lever Ponds. Should the outsourcing companies compromise on the standard of products, this may lead to dissatisfaction among customers. The dissatisfied customers will stop using Lever Ponds products and will use competitors' products instead, thus lowering sales.

Lever Ponds has kept a strict watch on the quality of products manufactured at the outsourcing companies. This has included providing on the job training to the outsourcing companies' manufacturing and quality control teams, checking on samples before they are released to the trade and being in constant contact with the quality control teams at the outsourcing company.

8. Lever Ponds may be exposed to breeches of confidentiality (with regard to product formulations, new innovations and bills of material) especially in cases where the outsourcing company also has Lever Ponds competitors as customers. In the outsourcing companies in the study, all had customers that were Lever Ponds' competitors. One outsourcing company mentioned that some potential customers had not engaged in their services due to the outsourcing company having close links with Lever Ponds.

Lever Ponds has a strict policy on breeches of confidentiality, as a breach may affect contract renewal. The outsourcing companies' staff is also very careful that a customer is not exposed to another customer's products or production process. For example, when the researcher visited Paccon Research, she was not allowed to have a tour of the premises, as a competitor's new innovation was being manufactured.

The challenge facing Lever Ponds and the outsourcing company is how to improve their working relationships and look for opportunities that will benefit both parties.

Communication between the parties should become a regular feature. At some of the outsourcing companies, meetings between both parties are held on a monthly basis. This feature should be common to all outsourcing companies, so that areas of concern are discussed before problems arise.

At Lever Ponds, there should be a formal manner of communication between all the departments that deal with outsourcing companies. This would ensure that all the departments are aware of developments at outsourcing companies.

The outsourcing strategy at Lever Ponds has been a success, as the quality of products manufactured at the outsourcing companies is comparable to the quality of products manufactured in house at Lever Ponds. Customers have raised complaints for similar issues at the outsourcing company as well as Lever Ponds.

In the case of core third party products, the manufacturing costs have decreased, as Lever Ponds no longer has to invest in specialised machinery and payment of salaries in the areas where workstations have been shut down. In the case of non-core third party products (normally made in house at the Lever Ponds factory), being manufactured at outsourcing companies, manufacturing costs have increased, as a premium is paid to have products manufactured at outsourcing companies.

In conclusion, the outsourcing strategy has been a success and both parties need to be commended on how far they have come in such a short space of time. Systems have been improved and areas of weakness have been identified and corrective action plans are underway.



In order to assess whether or not the third party outsourcing strategic plan (introduced in 2003) has had a significant impact on the improvement of the outsourcing process, further investigations need to be done. Since the strategy is still at inception stage, it is too early to pass judgement on its effectiveness. Should the objectives outlined in the strategic plan be realised, the outsourcing process at Lever Ponds will be more effective.

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**UNIVERSITY OF NATAL**

**QUESTIONNAIRE**

I am an MBA student at the University of Natal conducting a study on outsourcing service. Your kindness in completing the questionnaire is appreciated. All the information in this questionnaire will be kept confidential and shall only be used for research purposes. **Please do not write your name.**

**A. DEMOGRAPHIC DATA**

1. Gender      Male      Female  
☐      ☐
2. Age Group      18-25 yrs      26-33yrs      34-41yrs      42yrs & above  
☐      ☐      ☐      ☐
3. Marital status      Never Married      Married      Divorced      Widowed  
☐      ☐      ☐      ☐
4. Highest qualification  
Certificate      Diploma      Degree      Postgraduate  
☐      ☐      ☐      ☐
5. Department      Planning      Accounts      Quality Assurance      Human Resources  
☐      ☐      ☐      ☐
6. Years of services      0-1 yr      2-5 yrs      6-10yrs      11yrs & more  
☐      ☐      ☐      ☐
7. Company designation: please specify in the space provided  
Manager      Management Trainee      Assistant      Clerk

**B.       OUTSOURCING SERVICES.**

1.       Assess each of the following, from 1 to 5, in terms of their importance, as advantages. For example, if you feel meeting production targets is a very important advantage of outsourcing, then put 5 in the appropriate box. If you consider it as mildly important, then put 3. If you consider it a very unimportant advantage of outsourcing, then put 1 in the appropriate box. There is no right or wrong answer, so please indicate what you really think.

ADVANTAGE	RANK				
Meeting production demands	1	2	3	4	5
Time and resources concentrated on core products	1	2	3	4	5
Lowering of production costs	1	2	3	4	5
Availability of specialized machinery	1	2	3	4	5
Other (Specify)	1	2	3	4	5

2.       Assess each of the following, from 1 to 5, in terms of the obstacles inherent in conducting business with 3<sup>rd</sup> parties. For example, if you feel that stock shortages is the most common problem in conducting business with 3<sup>rd</sup> parties, then put 5 in the appropriate box. If stock shortages are not a serious problem, then put 3. If stock shortages are not a problem at all, then put 1. There is no right or wrong answer, so please indicate what you really think.

OBSTACLE	RANK				
Stock shortages	1	2	3	4	5
Weaknesses in Quality Control	1	2	3	4	5
Timeous deliveries	1	2	3	4	5
Communication breakdowns	1	2	3	4	5
Wastage and pilferage of stock	1	2	3	4	5
Unfamiliarity with LP production methods	1	2	3	4	5
Other (Specify)	1	2	3	4	5

3. Assess each of the following from 1 to 5, as weaknesses that may have an impact on the 3<sup>rd</sup> party process. If you feel that the ordering system is a major weakness, then put 1 in the appropriate box. If you feel that the ordering system is an average weakness, then put 3 in the appropriate box. If you feel that the ordering system is not an important weakness in the ordering system, then put 5.

WEAKNESSES	RANK				
Ordering system	1	2	3	4	5
Collection of raw materials from LP to 3 <sup>rd</sup> Party)	1	2	3	4	5
Delivery of raw materials (from 3rd party to LP)	1	2	3	4	5
Payment procedure	1	2	3	4	5
Other (specify)	1	2	3	4	5

4. Since the outsourcing of core products to outsourcing companies, to your knowledge, has there been an increase in customer complaints?

Yes ☐ No ☐ Don't know ☐

Assess the following customer complaints from 1 to 5, with 5 being a very frequent and 1 a very infrequent complaint.

COMPLAINTS	RANK				
Poor quality of product	1	2	3	4	5
Faulty nozzles	1	2	3	4	5
Faulty caps	1	2	3	4	5
Other (specify)	1	2	3	4	5

5. What costs have arisen as a result of outsourcing?
- In each case indicate the extent to which you consider each aspect to have contributed to the rise in costs through outsourcing. Allocate 1 if you feel the rise in costs as being small or negligible and 5 if you feel the rise in costs as being considerable.

COSTLY RESULTS	RANK				
Increase in product prices	1	2	3	4	5
Costs of re-working faulty workmanship	1	2	3	4	5
Loss of direct relationship with suppliers	1	2	3	4	5
Loss of personnel as a result of operations ceasing	1	2	3	4	5
Increase in transportation, storage and warehousing	1	2	3	4	5
Other (specify)					

6. What costs have decreased as a result of outsourcing?

In each case indicate the extent to which you consider each aspect to have contributed to the decrease in costs through outsourcing. Allocate 1 if you feel the decrease in costs as being small or negligible and 5 if you feel the decrease in costs as being considerable.

DECREASED COSTS	RANK				
Factory overheads	1	2	3	4	5
Costs of buying and maintaining specialized machinery	1	2	3	4	5
Salaries	1	2	3	4	5
Costs associated with critical stocks	1	2	3	4	5
Other (specify)	1	2	3	4	5

C.     **OUTSOURCING SERVICES**

1.     Have there been financial losses as a result of outsourcing?

Yes

☐

No

☐

Don't know

☐

If yes, briefly give details.

2.     With the trend of using outsourcing companies set to continue:

(i)     will Lever Ponds increase the number of suppliers?

Yes

☐

No

☐

Don't know

☐



Explain briefly

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(ii) will existing outsourcing companies manufacture more products in the future?

Yes ☐ No ☐ Don't know ☐

Explain briefly

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3. Do outsourcing companies improve their service delivery with time?

Yes ☐ No ☐ Don't know ☐

Elaborate

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4. On a comparative basis, is it cheaper to produce a product at the Lever Ponds factory or at a outsourcing company?

Yes ☐ No ☐ Don't know ☐

Explain briefly

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5. In your view, has the outsourcing strategy adopted been successful?

Yes ☐

No ☐

Don't know ☐

Explain briefly

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You have now come to the end of this questionnaire.

Many thanks for your co-operation.